EFFECTS OF THE INDETERMINATE FRANCHISE UNDER STATE REGULATION

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The past history of public utility operation under franchises granted by municipalities or other public authorities is largely a history of mistaken policy resulting in harm to one or the other party or, more often, to both parties to the contract. A great variety of franchise provisions have been tried in innumerable combinations and it would seem that every type from the short-term franchise to the perpetual franchise has been tried under a wide range of conditions and circumstances. The experience has been on the whole an unfortunate one leading to a deep-seated distrust on the part of all concerned. A great conservatism has grown up so that, while the dissatisfaction with the old form of franchise is general and shared alike by the utilities and the public, past experience would cause them to look with suspicion upon any proposed change in practice. Thus when Wisconsin wrote the indeterminate permit provision into her public utilities law, the companies were slow to take advantage of it, fearing a possible new menace to their investment; and on the other hand the municipalities or the general public were equally cautious in their attitude toward the adoption of the new policy. Indiana included in its public utilities law the indeterminate permit provision as it was originally enacted in Wisconsin. As a result of its recent adoption by these two states, the indeterminate permit has attracted the renewed attention of every one interested in public utilities or public utility regulation. The general attitude toward the indeterminate permit is that it is a new thing and time alone can prove the wisdom of its adoption, overlooking the fact that the indeterminate franchise was in use long before it was incorporated in the Wisconsin utilities law.

The Indeterminate Franchise in Massachusetts

The earliest franchises granted to street railway companies in Massachusetts are of this type and its use has been continued throughout the state, down to the present time.[1] The parties to a term franchise attempt to foresee and provide for all possible contingencies that may arise during the term specified in the franchise. Such franchises are long and involved and yet prove to be inadequate and a restriction on progress and normal development. The franchise adopted in Massachusetts is a simple "grant of location" omitting all technicalities, reservations and safeguards. It contains no fixed time limit but provides for revocations at the will of the local boards.

In 1898 a special committee, appointed by the Massachusetts legislature, made its report on "Relations Between Cities and Towns and Street Railways." This committee did not depend upon secondary sources but made its own investigation of actual conditions in this country and in Europe. Extracts from this report follow:

A more fixed tenure of franchises is, however, by the terms of the act creating the committee, one of the two points it is especially instructed to consider. The substitution for the present indefinite concessions of a specific and binding contract, covering a fixed term of years, setting forth the rights and obligations of the parties thereto and containing a rule of compensation for the purchase of the property in case of failure to renew, at once suggests itself as a measure of reform; and yet, in the course of the protracted hearings before the committee, it was very noticeable that no such charge was advocated by the representatives of the municipalities or of the companies, nor, apparently, did the suggestion of such change commend itself to either. Some amendments in details of the existing law and partial measures of protection against possible orders of sudden ill-considered or aggressive revocations were suggested, but it is evident that, while the municipalities wanted to retain as a weapon—a sort of discussion bludgeon—the right of revocation at will, the companies preferred, on the whole, a franchise practically permanent, though never absolutely certain, to a fixed contract tenure for a shorter term, subject to the danger of alteration at every periodic renewal. . . . .

There is probably no possible system productive of only good results and in no respects open to criticism; but, in fairness, the committee found itself forced to conclude that the Massachusetts franchise, which might perhaps not improperly be termed a tenure during good behavior, would in its practical results compare favorably with any. . . . . The investigations of the committee have not led its members to believe that the public would derive

[1] *Relations Between Cities and Towns and Street Railways.* Massachusetts Special Committee, Charles Francis Adams, Secretary (1898), p. 17.

benefit from the substitution of any form of term franchise now in use in place of the prescriptive Massachusetts tenure."[2]

The committee speaks of this franchise as having given satisfaction for half a century. Some changes were suggested, however. (1) Local authorities should be granted explicit power, thereafter, to impose such terms and conditions as they deem the public interests demand. (2) Companies should be protected from new and perhaps unreasonable conditions sought to be imposed by way of alterations and extensions. (3) Companies should be granted the right to appeal from revocation to the board of railroad commissioners. (4) Moreover, the "grants of location" while providing for revocation at any time did not provide for purchase by the municipality at a fair compensation and the committee recommends that such a provision be incorporated.

Adoption by the Federal Government

The indeterminate franchise has been adopted by the national government. All franchises granted by Congress to public service corporations operating in the District of Columbia, Porto Rico and the Philippine Islands are indeterminate, subject to amendment or repeal at any time.[3] The use of this type of franchise has been extended to the various departments of the federal government. The water power permit granted in the department of the interior to the International Power and Manufacturing Company for the development of a large power project on Clark's Ford, Pend d'Oreille County, state of Washington,[4] is an example of such franchise policy. The permit is indeterminate but revocable after due notice and opportunity for hearing, for violation of the terms of the permit, of the provisions of the general regulations, or pursuant to the provisions of the act of Congress of February 15, 1901.[5]

[2] Ibid., pp. 18, 20.

[3] *The Indeterminate Franchise for Public Utilities*, Report by Commissioner Milo R. Maltbie, Chairman Public Service Commission, First District, pp. 25–28.

[4] *Development of Water Power*, Senate Document No. 147.

[5] 31 Stat., 790.

Chicago Traction Agreements

Since it has gained considerable attention among those interested in traction problems, the franchise agreement existing between Chicago and the street railway companies may be cited as another example of the indeterminate franchise. The report of the Chicago Street Railway Committee on "Public Control and Duration of Grants" in 1900 says:

> The street railway commission believes that the definite term grant, whatever its duration, is open to serious objections. It is of opinion that a grant of indefinite duration, but subject to termination at any time upon certain conditions, one of which should be the taking of the property of the grantee at a fair valuation, would be productive of much better results.

This is not a complete account of the extent of the adoption of the indeterminate permit. These examples, perhaps the best known, have been given to show that it is not an untried measure. The main object of this article, however, is to consider the use of this form of franchise under state regulation of public utilities.

Wisconsin Law and Practice

Naturally Wisconsin is the chief source of information in regard to the indeterminate permit provisions in state regulation of public utilities, the effect on the companies operating under such a permit, the benefits to the consumers or the public and, in general, the legal aspects of its adoption.

The law, as originally enacted, gave the companies the right to surrender their franchises and receive in lieu thereof indeterminate permits, fixing a definite time limit within which such action could be taken. Less than one in ten of the public service corporations availed themselves of the privilege.[6] Later legislation extended this time limit and by amendment in 1911 every franchise was, without action of the company, "altered and amended as to constitute and to be an 'indeterminate permit.'"

Commissioner Roemer, in commenting on the reluctance of the companies to surrender their franchises, states the chief objections offered by the utilities, as follows:

[6] *Some Features of State Regulation of Public Utilities*, by John H. Roemer, Member of the Wisconsin Railroad Commission, p. 22.

(1) A doubt as to the legal right of the directors and stockholders to make the surrender without the consent of the bondholders whose mortgage security covers and includes the franchises of the corporation, (2) the practical impossibility of ascertaining all the bondholders and acquiring their consent, and (3) the erroneous, though perhaps not ill-founded, conception of the value of such franchises. . . . . [7]

Similar objections have been urged by companies when the adoption of indeterminate permit was discussed in Indiana and Illinois. Commissioner Roemer, a lawyer whose long experience as a member of the Wisconsin commission makes him one of the highest authorities in this field, has this to say in answer to all such objections:

As all secondary or special franchises granted directly or indirectly by the legislature are non-exclusive, subject to eminent domain by municipalities, and resting entirely upon the good faith of the people of the state, as they may be repealed at any time by the legislature, I can see no element of value in such franchises that makes them a more desirable acquisition of a public service corporation than the practically perpetual exclusive franchises provided by the statute. . . . .

The legal question involved in the surrender of the franchise without the consent of the bondholders has never been decided by the courts. It is now presented before the district court of the United States in an appeal of certain bondholders of the Oshkosh Water Works Company to set aside the order of the Wisconsin commission in the matter of the purchase of the Oshkosh Water Works by the city of Oshkosh.

State commissions, delegated by the legislature to require public utilities to give adequate service at just and reasonable rates, have made rulings[8] contrary to the provisions of franchises between the company and the municipality and between the company and its customers. Such decisions have been upheld by the courts.[9] In view of such decisions, it would seem that, regardless of any possible

[7] Supra, p. 23.

[8] Ashland *vs.* Ashland Water Co., 4 W. R. C. R., p. 305; City of Washburn *vs.* Washburn Water Works, 6 W. R. C. R., 95; City of Neenah *vs.* Wis. Tr. Lt. H. & P. Co., et al., 6 W. R. C. R., 401, etc.

[9] Greenwood *vs.* Freight Company, 105 U. S., 13, 19; City of Ashland *vs.* Wheeler, 88 Wis., 607, 616; Milwaukee El. Ry. & Lt. Co. *vs.* Wisconsin Railroad Commission, 142 N. W., 496; Phillipsburg Horse Car Railroad Company, N. J., sup. ct.

advantageous provisions that may be included in a utility's franchise, there is little to lose and much to gain in the surrender of the franchise for an indeterminate permit under regulation similar to that provided in Wisconsin.

In decisions and public addresses[10] the Wisconsin commissioners have discussed various features of the indeterminate permit and have pointed out the advantages accruing to the company and the public.

In the Appleton case, the commission holds that the indeterminate permit is

> more valuable than the ordinary special franchises, because the company now has a legally protected monopoly and is subject to no different supervision and regulation than it would have been had it continued to operate under its original grant. Furthermore, its investment is now protected not only against the consequences of competition, but also against the possibility of total loss on the expiration of the original grant. It can never be deprived of its property except on the payment of the fair value thereof by the municipality. . . . . [11]

The indeterminate permit under the Wisconsin law and practice is explained in a later decision.

> By making a surrender of its franchise and accepting in lieu thereof an indeterminate permit, a public utility acquires, in effect, a legally protected monopoly and the right to continue its public service indefinitely. Such monopoly can not be destroyed except it be established that public convenience and necessity require a second public utility to engage in the same business in the municipality. By extending its plant to meet the public exigencies as they arise, and by discharging its public functions properly, a public service corporation may maintain its monopoly of the business as long as it continues operation. Neither can its enjoyment of such monopoly nor its right to remain in the public service be terminated by the municipality, except upon payment to it of "just compensation" for all its "property actually used and useful for the convenience of the public." As a consideration for the valuable privileges thus guaranteed, the law provides that the term of the license

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[10] *Wisconsin Public Utilities Law, Three Addresses* by B. H. Meyer, pp. 19–21, 30–31; "Commission Control of Public Utilities," by John H. Roemer (*Electrical World*, Sept. 13, 1913, p. 532), and "Regulation *vs.* Profit Sharing," by Halford Erickson (*Aera*, p. 797–799).

[11] City of Appleton *vs.* Appleton Water Works Co., 5 W. R. C. R., 215, 284–285.

or franchise authorizing the maintenance and operation of the plant be determinable at the will of the municipality.[12]

The legality of the indeterminate permit has not been questioned by the Wisconsin courts. The supreme court has held that all the conditions and limitations of the old contract have been extinguished and an exclusive privilege to operate has been secured by the utility subject only to the conditions and limitations of the public utility law.[13]

Indiana

Of Indiana there is less to say because of the short time during which the law has been in operation. The law leaves the acceptance of an indeterminate permit optional with the utility fixing a limited period within which to make the transfer, as in the original Wisconsin provisions. In an address[14] by Judge J. L. Clark, member of the commission, it is pointed out that the commission's power to regulate utilities is not dependent upon their acceptance of the indeterminate permit. To the company he points out the advantage of the safety of investment, the ease with which the right to develop and extend the plant and system may be secured and the protection from competition. Protection from competition of a municipal plant can only be secured under the Indiana law to those utilities operating under an indeterminate permit.

Judge Clark has also seen fit to answer the objection usually raised by the companies. He states:

> The question has been raised as to the proper authority to execute the written surrender of a franchise. Some have contended that it requires the action of the stockholders and some have even contended that there can not

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[12] In re Appleton Water Works Co., 6 W. R. C. R., 97, 119.

Note. In the Appleton case and in a number of valuation cases the commission has held that an indeterminate permit does not have any value which can be included in a valuation for rate making purposes or in fixing the just compensation to be paid in case of purchase by the municipality.

[13] State ex rel Kenosha Gas & Elec. Co. *vs.* Kenosha Elec. Co., 145 Wis., 337; Manitowoc *vs.* Manitowoc & N. T. Co., Id., 13; La Crosse *vs.* La Crosse Gas & Electric Co., Id., 408; Calumet Service Company *vs.* City of Chilton. Decision of the Wisconsin supreme court.

[14] "The Indeterminate Permit," by Judge J. L. Clark, in *Fifth Annual Proceedings of the Indiana Electric Light Association*, pp. 26–39.

be a surrender so long as one stockholder withholds his consent, while still others go so far as to contend that the assent of bondholders must be obtained. These are all open questions, but it would seem that the procuring of a franchise for a corporation is the same as any other business transaction and may be handled entirely by the board of directors and the officers who execute their orders. Certainly bondholders can not be injured by surrendering a franchise of limited life and accepting one of indeterminate length of days.

New York

Commissioner Milo R. Maltbie made a report to the New York Public Service Commission, first district, upon the advantages and disadvantages of the indeterminate franchise. He discussed the bad effects of the short-term franchises which he says "have bound the industry so tightly that it could not progress or expand to meet the needs of the community," and of the long-term or perpetual franchises which have stood in the way of proper regulation. "The indeterminate franchise," he says, "in the main avoids these, and combines the desirable features of the short-term franchise by protecting public interests and of the perpetual franchise by stimulating private initiative. In one form or another it has been tried in many cities and found satisfactory."[15] In this report he does not urge its adoption but aims to report the whole question of franchises and leave it open for later decision. In 1909, however, the legislature, largely through Commissioner Maltbie's efforts,[16] amended the rapid transit act so as to provide for long-term franchises revocable at any time after the expiration of ten years upon the purchase of the property. Under this provision contracts have been drawn which are indeterminate and subject to regulation, for example the franchises of the McAdoo tunnels.[17] In Commissioner Maltbie's report, above mentioned, it is suggested that certain provisions should be included in an indeterminate permit. He advises provision for sale to another company as well as to the municipality. Other writers have advocated fixing the purchase price in advance, amortizing the original cost from earnings and various other provisions. These matters are either amply provided for or are entirely unnecessary and harmful under proper state regulation.

[15] *The Indeterminate Franchise for Public Utilities*, by Milo R. Maltbie, p. 4.

[16] Wilcox, *Municipal Franchises*, pp. 239–40, 518–551.

[17] Supra, p. 527.

Commissioner Maltbie alleged that, should the municipality exercise its right to purchase a utility's property before returns have been received sufficient to offset losses to capital either in the original construction or a subsequent extension of its plant or system, the commission or other arbitration body should make allowance to cover such losses to the company. Such an allowance should be taken into consideration in every purchase value, and this is the practice of the Wisconsin commission.

Other States

That public utilities are monopolies, natural monopolies, which should be protected from competiton and all unnecessary risks to capital eliminated, is the first step to be thoroughly recognized by those preparing the legal basis for state regulation. This is the fundamental principle which has led to the adoption of an indeterminate permit provision. Wisconsin and Indiana are the only states that have the indeterminate provision in their laws and Massachusetts has recognized its advantages and adopted it in practices. But this is not all. The fundamental principle of protected monopoly for public utility enterprises is more widely recognized and its recognition is becoming more general and is being more perfectly provided for. In the following states power has been given the railroad or public utilities commission to protect a company in a monopoly of its territory against a would-be competitor by requiring both private and municipal utilities under its jurisdiction to secure a certificate of public convenience and necessity from the commission before beginning operations: New York, Pennsylvania, Wisconsin, Indiana and Maryland.[18]

The following states provide such protection only as against the competition of private companies: Arizona, California, Colorado, Idaho, Illinois, Kansas, Maine (referendum now pending), Michigan, Missouri, New Hampshire and New Jersey.

No provision is made for such protection in Georgia, Oklahoma, Connecticut, Montana, Nevada and Rhode Island; and the Vermont law states that competition is not to be restricted.

[18] Baltimore is not required to obtain such a certificate before providing a municipal competitive plant.

In some instances as in Illinois and Missouri, the first draft of the bill provided for complete protection, that is, as against both private and municipal competition. Then interference came in and such terms were nullified or modified. The experts who draft the bill usually know what is best for the companies and the public. What is needed is more intelligent conception of economic facts upon the part of the legislatures enacting public utility laws.

The Georgia commission recognizes that its lack of jurisdiction to protect utilities from unnecessary competition is a great mistake and, in the recent Macon case,[19] has discussed the need for such powers and expressed its intention of asking the legislature to grant it the necessary jurisdiction. The Oklahoma Corporation Commission has made a similar request for jurisdiction to limit competition and unnecessary duplication.[20]

Constitutional Restrictions

In a number of states special laws or constitutional provisions limit the term of contract to from twenty-five to fifty years. And the question has been raised as to whether the indeterminate permit can be used in such states without a revocation of the law or the passing of a constitutional amendment.

The new constitution adopted in Michigan in 1908, effective January 1, 1909, limited the franchise period to thirty years. The city of Detroit has been granting "day-to-day" permits which are in reality indeterminate permits, and the question has been raised as to whether such permits can be granted under the constitutional limitation. This matter was discussed by Mr. James V. Oxtoby in a paper read before the Michigan Electric Light Association at Ottawa Beach in August, 1913, in which he says:

> If the meaning of the provisions in the constitution is that no term franchises can be granted by a municipality for a longer period than thirty years, then in my judgment it does not prevent the granting of special indeterminate permits. If it means that every franchise must be a time franchise, and must expire at some particular time, then we cannot have indeterminate permits.

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[19] Decided February 24, 1914.

[20] *1912 Annual Report*, vol. I, p. 11.

This question is before the supreme court of the state of Michigan in the case of Barton L. Peck *vs.* Detroit United Railway. Arguments and briefs have been submitted in this case. A decision in the matter will be of general interest as it will give some indication as to how serious these constitutional limitations will be in affording a delay to the general adoption of the indeterminate franchise.

Term Franchises versus Indeterminate Permit

Under state regulation, which assures the public adequate service at reasonable rates, a protection of the monopoly from competition and the elimination of all possible risks to capital invested result in benefits to all parties concerned. "Without protection of such monopolies only a limited supervision of their affairs by public authorities can be morally justified. This is almost axiomatic."[21]

Those advocates of the short-term restrictive franchise will discover sooner or later that burdens imposed upon public service companies rest heaviest upon the public served and that in order to secure the best service at the lowest rate the company must be given every advantage to develop and prosper. The Massachusetts committee sums up the situation in Great Britain as follows:

> The term franchise has there been universal since 1870 and the rights of the municipalities are so very carefully protected that their best interests have been systematically sacrificed. The municipalities have, in fact, been so afraid they would be outbargained that they have as a rule fairly overreached themselves; and now, after a lapse of twenty years, they are naturally served by undeveloped lines, with antiquated appliances, simply because they made it the distinct interest of the companies operating those lines to provide nothing better.[22]

They conclude that the indeterminate permit, even without the provision for the payment of a just compensation upon revocation of the grant by the municipality, has given a greater security to capital and induced markedly better service conditions.

[21] *Some Features of State Regulation of Public Utilities*, by John H. Roemer, p. 22.

[22] *Relations Between Cities and Towns and Street Railways*, Massachusetts Special Committee, Charles Francis Adams, Secretary (1898), p. 19; see also "Municipal and Private Operation of Public Utilities," in *National Civic Federation Report*. Part 1, vol. I, p. 464.

Operating under a franchise which is to expire at a certain time, the company is slow to make necessary expenditure for additions and betterments to the property as this means putting additional capital to the risk of partial or total loss. As a result, when the time arrives for settlement of the question of an extension of the franchise, the company is in a very disadvantageous position with its plant inadequate and its service open to severe criticism. The more exacting the terms imposed on the company the more exaggerated are the conditions. For example the Berlin street railway franchise (1891) provided that after a number of years street construction of all kinds was to revert to the city. The company was, therefore, forced to see that as little property as possible should be turned over to the city at the company's expense.

The utility is forced to connive for control in local politics. Litigation necessary to enforce contract terms or to meet circumstances which have not been provided for in the contract is a constant source of expense and usually results in bitter local feuds.[23] It is such conditions fostered by the term-franchise which are to be corrected by the indeterminate permit.

In the Calumet case, the Wisconsin supreme court held that the intent of the law is

> to displace the old situation, in its entirety, with all its complications, the growth of years, and we may add, with all its bitter controversies, the like of which is pictured in this case, and to substitute a new situation, all looking to unity, in practical effect, of a multitude of diverse units corresponding to the many outstanding franchises, and others in prospect, harmonizing by making them referable to a single standard, to wit: the public utility law, and to an ultimate single control, to wit: control by the trained impartial state commission, so as to effect the one supreme purpose, i.e., "the best service practicable at reasonable cost to consumers in all cases and as near a uniform rate for service as varying circumstances and conditions would permit—a condition as near the ideal probably as could be attained." Certain, that great object might well have aroused legislative ambition to a high plane, and inspired legislative wisdom accordingly, as it did in fact. Completeness of the law, so far as tested, and its success under the efficient conservative administration of it by the commission, bear witness to that. As, in effect, suggested in the LaCrosse case, evident purpose of the law to produce the ideal

[23] *The Causes and Effects of a Public Utility Commission*, by John H. Roemer, pp. 4–5; *Wisconsin Public Utilities Law, Three Addresses*, by B. H. Meyer, pp. 19–21; *The Indeterminate Franchise for Public Utilities*, by Milo R. Maltbie; *Regulation vs. Profit Sharing*, by Halford Erickson.

condition indicated, and the means designed to that end, are so plain, and, we may add, so legitimate from all constitutional viewpoints heretofore suggested, or reasonably apprehended, and from all viewpoints of public and private economy and sound public policy, that, if to leave the door open where there is an existing privilege covering the field, as in this case, to municipal invasions to any extent, would greatly disturb the harmony of the system the legislature purposed constructing, and prevent the full accomplishment of the end sought to be attained, judicial construction, if that were necessary to determine the meaning of the law, should rather lean toward preventing such result. . . . .[24]

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[24] Calumet Service Company *vs.* The City of Chilton. Decision of the Wisconsin supreme court, pp. 25–26.